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Price War Erupts Among Hong Kong Retailers

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Prepared by:

Howard R. Wetzel

U.S. Consulate General, Hong Kong

Drafted by:

Koon-Yu Lee

Report Highlights:

A major price war has broken out among Hong Kong major supermarket chains. The war was initiated because of the introduction of a new direct sales company - adMart. The price war has attracted a lot of attention from customers and it promises to have a major impact on most food retailers in Hong Kong.

Includes PSD changes: No
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Unscheduled Report
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In Hong Kong, where customers have come to identify shopping in supermarkets with high prices and imported foods, a price war has broken out during the month of August that may ultimately restructure the way such products are retailed and make them more price competitive. The two giants in the Hong Kong supermarket industry, Park'N Shop and Wellcome, who together account for between 75 and 80 percent of the market, are feeling competitive pressure from an upstart direct delivery business and have responded with sharp price cuts on certain loss leader items.

The cut-price grocery delivery service, adMart, started its business in early July by offering a range of consumer goods, non-grocery as well as dry good grocery items, at bargain basement prices. In order to reduce the cost of its products, adMart is importing products directly from manufacturers, bypassing the local distributors/wholesalers. adMart also sells some private label products. Boasting that it is able to cut costs by delivering directly to customers from its warehouse, adMart takes order mainly via telephone, fax and the Internet. Despite technical glitches - overloaded order lines, misprocessed orders and delays in delivery - adMart's service has proved an instant success due to low prices and heavy advertising. The remote order service is particularly attractive to Hong Kong consumers because it enables them to utilize their phones, faxes, computers or interactive TVs to escape supermarket lines. adMart was started by the media tycoon Jimmy Lai, who already had several successful consumer ventures including the Giordano garment store chain, Apple Daily Newspaper and Next magazine.

Soon after adMart launched its service, Wellcome Supermarket, the largest supermarket chain in Hong Kong in terms of number of stores, relaunched its home-shopping website. Arch competitor Park'N Shop (#2 in stores, but self-proclaimed #1 in sales and square footage) scrapped its "Shop N Drop" delivery fee of HK\$10 and expanded that delivery service from 54 outlets to all 180 outlets. On August 6, 1999, the supermarket price war was intensified after Park'N Shop launched a major price cutting campaign. The Park'N Shop campaign, in which 1000 items per week will be discounted for an indefinite period, was accompanied by intensive advertisement in all media (TV, newspapers, radio, etc.). Wellcome immediately responded with price reductions of its own.

Jusco, the largest Japanese-style department store chain in Hong Kong with 8 stores (7 with supermarket departments), announced that they would not join the price war in the beginning. However, on August 20, 1999, Jusco announced that they will conduct major sales at the end of August. In addition, they will extend their delivery service from three to all eight stores.

The price war has attracted the attention of consumers. Every Park'N Shop and Wellcome outlet has been packed with people trying to get the discounted products. Many outlets sold out all their stocks of discounted products in one day. Not only are customers packing the "real" stores of the two supermarket chains, they are also jamming the "cyber stores" of Park'N Shop and Wellcome as well. The two supermarkets chains are struggling to cope with the sudden surge in demand through the Internet. As a result, some orders have gone missing and goods have been arriving up to 4 days late despite pledges of same-day service. Wellcome was even forced to shut down its customer order website on August 14, 1999, one week after the beginning of price war, because the system could not handle the sudden huge increase in the volume of orders.

The discounted prices of some of the grocery items in the supermarket chains are very low and some items even lower than the wholesale prices. An interesting phenomenon is that after the launching of the price war, some small retail stores are buying their grocery stocks from the supermarket chains and reselling them in their small

stores. The supermarket chains have several advantages allowing them to obtain such low prices. First, they are able to place large orders for products. Second, supermarkets may arrange to pick up the products directly from the importers/distributors warehouses. Third, instead of asking distributors to distribute the products to their different supermarket locations, the supermarket chains may request distributors to ship all products to their central distribution centers where the chains themselves can distribute to their own store outlets. Both ways can reduce costs dramatically.

The price war promises to have a major impact on most food retailers in Hong Kong. adMart revealed that their daily sales have dropped one-third since the beginning of the price war. A representative of one of the two major chains told the Agricultural Trade Office that the last grocery price war in Hong Kong more than 10 years ago wiped out most of the small to medium sized operators and it expects the same effect this time around. For Park 'N Shop and Wellcome, it appears to be a costly battle for market share.

A recent study of Hong Kong's supermarket sector concluded that the success of these two supermarket giants has resulted mainly from their close association with sister property development firms within their respective holding companies, who were able to provide choice locations for their stores. Up until now, these two chains have been able to maintain a high margin duopoly on the retailing of imported and consumer-ready foods, with little challenge from smaller, lower capitalized chains selling a higher concentration of Chinese products and dry goods.

If the adMart challenge can be sustained, it may force lower margins upon the major supermarket chains and expand the segment of Hong Kong's population that routinely shops in those stores. This trend is already underway, as both Park 'N Shop and Wellcome have deliberately and successfully expanded their fresh produce and meat departments to compete with the traditional wet markets, and lower prices in those outlets will only boost their popularity with Hong Kong consumers.

The price war is even putting pressure on supplier relationships. The Hong Kong media have provided wide coverage to one conflict between a supplier and a supermarket. The price war has led Japanese dairy product giant Yakult to halt supplies of its yoghurt drink to Park'N Shop stores, which had been selling it at discounted prices. Park'N Shop sold the Yakult pack at HK\$7.50 when the promotion began, down from HK\$8.90.

Yakult management insisted on a retail price of no less than HK\$8.90 and refused to compromise. The drink was sold out at most Park'N Shop outlets, but Yakult refused to replenish the stocks unless Park'N Shop agreed on the price floor. Finally, on August 18, 1999, Yakult and Park'N Shop reached an agreement. Yakult agreed to lower the price floor and to replenish supplies to Park'N Shop. Park'N Shop in return put a whole page advertisement in a major local newspaper to announce the relaunching of Yakult. Major supermarket media campaigns and price cuts of this type are not at all traditional in Hong Kong.

It is also rumored that the major supermarket chains are trying to use their influence to cut off adMart from their suppliers. The rumor is that the major supermarket chains warn the suppliers that if they supply products to adMart, the major supermarket chains will stop ordering products from these suppliers. Since the major supermarket chains have substantial market share, suppliers cannot afford to lose such important clients. Hence, adMart's supply chain may be threatened.

No one knows when the price war will end, but the major retailers are clearly concerned about their reduced margins. At the same time, they seem resolved to stamp out a new, flashy low-price competitor. In the end,

maybe foreign food suppliers and Hong Kong consumers will emerge as the winners...for once.

(References: South China Morning Post July 18, 1999, August 7, 1999; August 12, 1999, August 15, 1999,; Hong Kong Economic Times, July 30, 1999, August 7, 1999, August 10, 1999, August 17, 1999, August 20, 1999, Next Magazine, issue 492, August 13, 1999)